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No. 93-71

In the Supreme Court of the United States

OCTOBER TERM, 1993

ROBERT AUGUST NELSON, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the government engaged in sentencing entrapment.

2. Whether the district court erred in calculating the amount of loss resulting from petitioners' fraud.

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-58a) is reported at 988 F.2d 798.

JURISDICTION

The judgment of the court of appeals was entered on March 2, 1993. A petition for rehearing was denied on April 12, 1993. Pet. App. 81a. The petition for a writ of certiorari was filed on July 12, 1993 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the District of Minnesota, petitioners were convicted on one count of conspiracy to defraud the United States, in violation of 18 U.S.C. 371; 17 counts of conspiracy to commit mail fraud, in violation of 18 U.S.C. 371 and 1341; and ten counts of interstate transportation of property taken by fraud, in violation of 18 U.S.C. 2314. Petitioner Jeffrey Heinen was sentenced to 18 months' imprisonment, to be followed by a three-year term of supervised release. Petitioner Robert Nelson was sentenced to 24 months' imprisonment, to be followed by a three-year term of supervised release. Petitioner David Heinen was sentenced to 30 months' imprisonment, to be followed by a three-year term of supervised release, and he was fined $250,000. Petitioner Data Hardware, Inc. (DHI) was sentenced to three years' probation and a $500,000 fine.

1. Petitioner DHI was in the business of storing, servicing, and refurbishing computers and computer-related equipment, primarily IBM's large mainframe computers. Petitioner David Heinen was the sole shareholder and president of DHI. Petitioner Nelson worked as DHI's vice-president. Petitioner Jeffrey Heinen worked as a computer technician at DHI. Gov't C.A. Br. 4.

Petitioners engaged in a fraudulent scheme to acquire new and expensive IBM computer parts called thermoconductor modules (TCMs) for a fraction of their value. A TCM is the "heart" or "engine" that drives IBM's large mainframe computers. Although all TCMs look alike, their capabilities and prices vary depending on their internal microchip circuitry. New

TCMs of the type involved in this case range in price from $50,000 to $140,000. To keep track of TCMs that it manufactures, IBM affixes to the outside of each TCM an aluminized label with a unique identification number. Gov't C.A. Br. 4-5.

IBM had a program under which it would exchange failing TCMs for replacement ones for a price of $17,000. As the result of its maintenance and refurbishing work, DHI possessed a large number of outdated TCMs with little market value. To take advantage of the IBM exchange program, petitioners devised a scheme to exchange its low-valued TCMs for new, high-valued TCMs. Petitioners would switch the labels on older TCMs it owned with the labels on newer, more sophisticated models that it also owned. The falsely labeled TCMs would then be taken to the IBM Parts and Distribution Center to make what appeared to be a like-for-like exchange. In fact, however, petitioners would receive a valuable TCM matching the part type identified on the fake label in return for its outdated TCM. As part of each transaction, petitioners signed an exchange agreement with IBM misrepresenting the part numbers and serial numbers of the TCMs they were exchanging. Petitioners also certified that they were engaging in the exchange to satisfy an immediate maintenance need. Gov't C.A. Br. 4-6.

From July 15, 1988, through December 14, 1988, petitioners traded 17 falsely labeled TCMs for new units with higher values. The value of the state-of-the-art TCMs petitioners acquired through the scheme was over $2 million. Gov't C.A. Br. 1, 6-8. Unbeknownst to petitioners, their scheme had been reported to the FBI in July 1988 by a DHI employee. With the employee's assistance and IBM's coopera-

tion, the FBI investigated the case and ultimately ended the fraud when it executed a search warrant at DHI's headquarters on December 14, 1988. *Id.* at 1.

2. In sentencing petitioners, the district court was required to determine the amount of loss caused by petitioners' fraudulent conduct. In making that determination, the district court subtracted the $17,000 per unit exchange price from the $2,035,000 aggregate retail value of the 17 fraudulently acquired TCMs, leaving a loss attributable to petitioners of $1,746,000. In calculating the loss, the district court declined to credit petitioners with a $1,746,000 payment made to settle a civil suit brought by IBM. Gov't C.A. Br. 67. The court accordingly increased petitioners' base offense level by nine levels as required by the version of the Sentencing Guidelines in effect at the time of petitioners' crimes. See Sentencing Guidelines § 2F1.1(b)(1)(J) (1988) (nine levels added for losses stemming from fraud between $1 million and $2 million).

3. On appeal, petitioners argued that they had been the victims of sentencing entrapment, and that as a result the sentencing court should have departed downward from their Guidelines sentencing range. They argued that the government was aware of their scheme in July 1988 but did not stop it until December 1988, and that the government delayed uncovering the scheme in order to manipulate the severity of their sentences. The court of appeals acknowledged that sentencing entrapment may be a valid consideration when "outrageous official conduct overcomes the will of an individual predisposed only" to committing small-scale crimes. Pet. App. 42a (quoting *United States* v. *Lenfesty*, 923 F.2d 1293, 1300 (8th Cir.), cert. denied, 499 U.S. 968 (1991)). The court of appeals held

that in order to prove sentencing entrapment, a defendant would have to show a lack of predisposition to commit the greater offense. Although the court expressed concern over the government's delay in stopping petitioners' scheme, it concluded that petitioners "make no argument which compels a conclusion that they were not predisposed to commit these offenses. Indeed, the facts refute such an argument." Pet. App. 43a-44a. The court accordingly held that no sentencing entrapment occurred in this case.

The court of appeals also held that the district court did not clearly err in calculating the amount of loss resulting from petitioners' scheme. The court concluded that under the Sentencing Guidelines, the amount of loss stemming from fraud is either the amount of loss the defendant intended to inflict or the actual loss resulting from the fraudulent conduct, whichever is greater. Pet. App. 38a-39a (citing *United States* v. *Edgar*, 971 F.2d 89, 93-95 (8th Cir. 1992)). The court of appeals also rejected petitioners' contention that Sentencing Guidelines § 2F1.1, Application Note 7(a) (1992) required a different calculation. That Note provides that "[i]n a case involving misrepresentation concerning the quality of a consumer product, the loss is the difference between the amount paid by the victim for the product and the amount for which the victim could resell the product received." Because TCMs are not consumer goods, and the transactions involved in this case were not consumer transactions, the court of appeals concluded that this commentary was inapposite. It reasoned that IBM's exchange program was intended to serve customers rather than to obtain used TCMs. Pet. App. 40a.

Finally, the court of appeals rejected petitioners' contention that the $1.7 million payment made by DHI to IBM in settlement of IBM's civil suit should be deducted from the loss amount. The court concluded that "[a] subsequent recovery of funds does not diminish the dollar amount applicable in sentencing. *Sentencing may be based on 'the [amount of] possible* loss the defendant attempted to inflict.'" Pet. App. 41a (quoting *United States* v. *Prendergast*, 979 F.2d 1289, 1292 (8th Cir. 1992)).

ARGUMENT

1. Petitioners contend (Pet. 11-18) that the government engaged in sentencing entrapment by waiting to stop petitioners' fraudulent scheme until after they had engaged in 17 transactions involving a large sum of money so as to increase the length of their sentences.

The FBI became aware of petitioners' scheme in July 1988, around the time of the first exchange of falsely labeled TCMs. Instead of interrupting the unlawful scheme at that point, the FBI continued to investigate with the cooperation of IBM and the DHI employee who first revealed the plot. The scheme continued until the government executed the search warrant at DHI in December 1988. By that time, petitioners had engaged in 17 fraudulent transactions.

Petitioners claim that the government delayed interrupting their scheme in order to enable them to commit more crimes so that they would be exposed to more severe sentences. That delay, according to petitioners, violated the separation of powers doctrine and due process. Even if petitioners were correct that government manipulation of a defendant's conduct with the result that the defendant receives a

more severe sentence might in some circumstances raise constitutional concerns, no such circumstances are present in this case.

According to petitioners, sentencing entrapment occurs when a defendant is predisposed to commit a minor offense, but the government induces him to commit a greater one. See *United States* v. *Dickey*, 924 F.2d 836, 839 (9th Cir.), cert. denied, 112 S. Ct. 383 (1991); *United States* v. *Stuart*, 923 F.2d 607, 614 (8th Cir.), certs. denied, 499 U.S. 967 and 112 S. Ct. 145 (1991). Although several courts of appeals have discussed the doctrine, no court has found that such entrapment occurred on the facts before it. See *United States* v. *Connell*, 960 F.2d 191, 195 (1st Cir. 1992); *Stuart*, 923 F.2d at 614; *Lenfesty*, 923 F.2d at 1300; *United States* v. *Streeter*, 907 F.2d 781, 786-787 (8th Cir. 1990); *Dickey*, 924 F.2d at 839.

As in previous cases, the facts here cannot support a finding that the government manipulated the scope of petitioners' crimes for the purpose of increasing petitioners' sentences. In this case, the government took no action that induced petitioners to commit *any* offense, much less a greater one than they otherwise would have committed. Unlike the cases in which sentencing entrapment has been discussed as a possibility, which typically involve sting operations in which a government agent or informant has a role in the defendant's crime, the government had no part whatever in petitioners' criminal scheme. Petitioners could have halted their scheme at any time; no government actor in any way encouraged them to go forward.

The facts here contrast sharply with the facts in other cases in which sentencing entrapment claims have been made. For example, in *Lenfesty* a govern-

ment agent made nine drug purchases from three dealers within the same organization. 923 F.2d at 1295. The government agent therefore provided some inducement to the defendants to continue their illegal course of conduct. Similarly, in *Stuart* government agents provided the defendant with the funds that allowed him to purchase a larger quantity of drugs than he otherwise would have been able to buy. 923 F.2d at 610. Notwithstanding the government's role in those cases in encouraging the criminal conduct and in determining the scope of that conduct, the courts did not find sentencing entrapment. The same result follows here, where the government did nothing to encourage petitioners in their criminal conduct.

Petitioners rely on the Fifth Circuit's decision in *United States* v. *Richardson*, 925 F.2d 112, cert. denied, 111 S. Ct. 2868 (1991). That case involved a challenge to a sentence for a money laundering conviction that was based upon the amount of money a government agent had provided to the defendant. The court concluded that no government misconduct had occurred, although it agreed that it might implicate separation of powers principles if the Executive Branch "had the unilateral power to directly and automatically rachet up a sentence" by manipulating the amount of money the defendant laundered. 925 F.2d at 117. The court concluded, however, that "the district court clearly retained the authority" to sentence the defendant based on the amount of money it believed was legitimately part of the defendant's scheme. *Ibid.*

Even if the concerns expressed by the court in *Richardson* would support reducing a sentence in some case, those principles have no application here.

In this case, no government actor ratcheted up petitioners' sentence by giving them access to more money or encouraging them to engage in more widespread criminal conduct than they otherwise would have. In fact, each of the 17 transactions in which petitioners voluntarily engaged—without any governmental role—constituted discrete crimes. The government was entitled to continue its investigation while those crimes occurred to determine the nature and scope of petitioners' conspiracy and to gather the evidence necessary to prove petitioners' guilt. A defendant should not escape or minimize the punishment for his crimes simply because the government failed to stop him from committing them.

2. Petitioners contend (Pet. 18-23) that the district court erred in calculating the amount of the loss attributable to their fraud.

Petitioners argue that the mislabeled TCMs (which IBM retained) were not worthless, and that their value thus should have been subtracted from the loss amount calculated by the district court. They also argue that their $1.7 million payment to IBM in settlement of a civil suit should have been deducted from the loss amount. If those deductions had been made, the amount of loss attributable to the fraud in this case would have been zero. Petitioners' contentions are without merit.

A district court's calculation of loss in a fraud case is reviewable only for clear error. *United States* v. *Smith*, 951 F.2d 1164, 1166 (10th Cir. 1991); *United States* v. *Haddon*, 927 F.2d 942, 952 (7th Cir. (1991); *United States* v. *Davis*, 922 F.2d 1385, 1387-1388 (9th Cir. 1991). In this case, the record amply supports the district court's conclusion that IBM stood to lose—and petitioners stood to gain—the entire purchase

price of the high-valued TCMs less the $17,000 payment petitioners made for each. There was no ready market for the low-valued TCMs that petitioners forced upon IBM. And petitioners delivered those TCMs to IBM on the explicit representation that they were failing. Nor was it error for the district court to refuse to credit petitioners with restitution payments made to IBM in settlement of a civil suit.[1] Petitioners cite no authority for the proposition that such a payment should be viewed as reducing their culpability for their crimes. In short, the district court's figure of $1,746,000 was a reasonable judgment about the actual and intended loss resulting from petitioners' scheme, even though IBM subsequently recouped all of that loss through collateral proceedings.

Petitioners contend (Pet. 20-23) that the decision in this case conflicts with the decisions in *United States* v. *Kopp*, 951 F.2d 521 (3d Cir. 1991); *United States* v. *Smith*, 951 F.2d 1164 (10th Cir. 1991); and *United States* v. *Schneider*, 930 F.2d 555 (7th Cir. 1991). That contention is incorrect.

The cases relied on by petitioners applied the same general legal analysis used by the court of appeals in this case, but involved distinct factual circumstances leading to a different result. Two of the cases involved fraudulent misrepresentations made to obtain real estate loans. The courts in those cases concluded that the actual out-of-pocket costs to the lenders should be the relevant measure because the

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[1] Although petitioners emphasize (Pet. 8, 18-19) that the payment was made two years before they were indicted, they do not mention that it was made after their scheme had been exposed and in settlement of IBM's civil suit.

loans were secured by the value of the property regardless of the defendant's misstatements. See *Kopp*, 951 F.2d at 525; *Smith*, 951 F.2d at 1166. The third case involved fraudulent misrepresentations in bids for government contracts, and the court concluded that the measure of loss should be the costs to the government of procuring a different contractor rather than the gross amount of the contracts. *Schneider*, 930 F.2d at 557-558. Because the contracts at issue might have been performed despite the fraud in procuring them, the gross value of the contracts did not bear any relationship to the losses incurred by the defrauded party. *Ibid.*

Although the cases petitioners rely upon measured loss by reference to the victim's actual losses, their legal analysis is consistent with that of the court of appeals in this case. Thus, each case relied upon by petitioners recognized—as the court of appeals did in this case—that as a general matter the greater of actual or intended loss should be the relevant measure. See *Kopp*, 951 F.2d at 529; *Smith*, 951 F.2d 1166; *Schneider*, 930 F.2d at 558.[2] Here, there is every

[2] Even if petitioners were correct in contending that the circuits are in conflict, this case nonetheless would not warrant review. If, as petitioners urge, they had been credited with the value of the failing TCMs, their sentencing range would have been the same. Under the version of the fraud Guideline then in effect, losses of between $1 million and $2 million called for a nine-level increase in the defendant's offense level. The mislabeled TCMs IBM took possession of had a market value of up to $10,000 each (Gov't C.A. Br. 5), which would amount to a $170,000 total credit for the 17 TCMs. If that amount had been deducted from the district court's $1,746,000 loss figure, the amount of losses attributable to petitioners would still have been between $1 million and $2 million. Their offense level therefore would not have been different.

reason to use intended loss as the measure, because IBM stood to lose the full $1.7 million if petitioners' scheme succeeded.

Moreover, the question raised by petitioners is one of Guidelines administration that is readily resolved by the Sentencing Commission in the ordinary course of its business. See *Braxton* v. *United States*, 111 S. Ct. 1854, 1857-1858 (1991). In fact, the Sentencing Commission has recognized that a different loss measure may be appropriate in cases in which the threatened losses to the defrauded party do not accord with the defendant's potential gain. In amendments to the Guidelines commentary, the Sentencing Commission has recognized that such circumstances justify a different approach to loss calculation than the normal approach of relying on the greater of actual or intended losses. See Sentencing Guidelines § 2F1.1, Application Note 7(b) (1992) ("In fraudulent loan application cases and contract procurement cases, the loss is the actual loss to the victim.").

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1993